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E.O. 12958: N/A

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SUBJECT: A/S VALENZUELA DISCUSSES CHILE'S ECONOMIC STRENGTHS AND ROLE
IN THE REGION WITH MINISTER OF FINANCE

¶1. (SBU) SUMMARY: A/S Valenzuela met with the Minister of Finance on January 12 to discuss Chile's accession to the Organization for Economic Cooperation and Development (OECD), the state of Chile's economy, and plans for the next Chilean administration. The discussion ranged from innovation to education to economic instability in Venezuela and Argentina. Two key issues were Inter-American Development Bank (IDB) capitalization for the region, which Chile characterized as "miniscule" considering the region's economy, and a push from Ministry of Finance senior officials to sign a bilateral tax treaty the first week in February, in Washington DC. END SUMMARY.

¶2. (U) On January 12, A/S Valenzuela met with Minister of Finance Andres Velasco and International Affairs Coordinator Raul Saez. The Ambassador, Senior Poloff and E/Poloff (notetaker) accompanied A/S Valenzuela.

OECD Accession: An Opportunity for Expanding Views

¶3. (SBU) In response to A/S Valenzuela's congratulations on Chile's pending OECD membership (the Accession Agreement was signed the day before on January 11), Velasco commented that Chile would be an additional voice in the organization's Asia-Pacific Economic Cooperation (APEC) group and will provide some balance against the influence of European countries. He also expressed appreciation for strong U.S. support in Chile's accession process. Saez noted that Chile, as well as being willing to learn from other members, has a fresh perspective to add to the OECD dialogue.

Chilean Economy Will Be Strong in 2010...

¶4. (SBU) Expressing concern about the economic policies and high inflation of both Argentina and Venezuela, Velasco solicited A/S Valenzuela's views on the economic direction of the region. This led to a broader discussion of the boom-bust cycle. When asked about the state of Chile's economy, Velasco explained

Chile had a "good" year in 2009 for several reasons: it had no finance/credit problems, economic production in Chile was not dislocated as it was elsewhere, local consumer demand increased, and the country continued to have strong exports.

15. (SBU) Velasco stated that the impact of the global financial crisis was tempered in Chile because the productive sector was not disrupted. He elaborated that businesses were able to get credit, consumers continued to spend, and unemployment was not a large problem. He characterized exports as "strong," specifically citing copper, fruit and wood and Chile's significant market share in the U.S., Europe and China.

...and There Will Be an Investment Boom

16. (SBU) Velasco projected that the Chilean economy would fully recover in 2010, and that it will experience a "boom" in investment compared to previous years. He said investment is essential for Chile to maintain growth at 5-5.5 percent and asserted that the country's development agency, CORFO, was doing an excellent job of both promoting innovation - an important strategy for growth - and

increasing investment. Velasco strongly emphasized the importance of education, especially advanced education, to raising economic growth.

Recommended Priorities for Next Administration: Education, Taking on Teachers' Union

17. (SBU) Responding to Velasco's comment that Chile intended to send 2,000 PhD students abroad a year, A/S Valenzuela noted that the split between public and private education, at all levels, is an "Achilles' heel" for the country. Velasco responded that there had been "huge strides" in providing education in the past 20 years, citing that 97% of the population completes primary education, over 90% start secondary education, and nearly 80% graduate from high school. Velasco said it is "revolutionary" that four out of 10 Chileans now attend university (an increase from one in 10) and pointed out that by 2010 this is projected to be six out of 10.

18. (SBU) Velasco gave credit to both Chilean President Michelle Bachelet and presidential candidates Eduardo Frei and Sebastian Pinera for not giving in to demands during the recently-concluded lengthy teachers' strike, which started out with 80% participation and dwindled to 8% at the end. Saying that public school enrollment is "collapsing," he suggested that proactively taking on the teachers' union and its claim that the government owes it an "historic debt" (deuda historica), should be a priority for the new Chilean president, even though it may result in a 1-2 month strike. He further commented that education is an issue that will make or break the next administration.

Chile Wants to Sign Bilateral Taxation Treaty in February

¶9. (SBU) Calling resolution of the double taxation issue an important outcome of Chile's OECD accession process, Velasco said the GOC would like to find a date during the first week of February to sign the bilateral tax treaty with the U.S. Mentioning that this has been an issue for almost two decades, he indicated that signing taxation treaties with the U.S. (and Australia) is critical to demonstrate Chile's commitment to high investment standards, especially in the context of OECD membership. Saez stated that the text will be ready at the end of January, and Velasco said he could travel to Washington DC for the signing in first week in February.

Concerns about IDB (Under-) Capitalization for the Region

¶10. (SBU) Velasco said he was concerned about the IDB's ability to support contracyclical adjustment programs, given its liquidity line of only about \$6 billion, an amount he described as "miniscule" in view of the combined GDP of countries in the region. Velasco conveyed a sense of urgency because of the level of unrealized losses due to the financial crises and upcoming meetings.

¶11. (U) The Assistant Secretary cleared this cable.
SIMONS